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# In the Supreme Court of the United States

OCTOBER TERM, 1959

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No. 233

VANCE L. WILEY and Wife, LUCILLE J. WILEY,
PETITIONERS

*v.*

COMMISSIONER OF INTERNAL REVENUE

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FRANK D. WILEY and Wife, WENDLA A. WILEY,
PETITIONERS

*v.*

COMMISSIONER OF INTERNAL REVENUE

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*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT*

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## BRIEF FOR THE RESPONDENT IN OPPOSITION

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### OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (Pet. 11-22) are not officially reported. The Court of Appeals did not write an opinion.

## JURISDICTION

The order of the Court of Appeals was entered April 24, 1959 (Pet. 23-25), and is reported at 266 F. 2d 48. The petition for certiorari was filed July 20, 1959. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

## QUESTION PRESENTED

Whether the courts below correctly held that sums credited by financial institutions to the reserve accounts of the taxpayers' accrual basis partnership, which credits represented a portion of the finance charges on installment sales made by the partnership, were taxable income to the taxpayers for the year in which the sales and credits were made.

## STATUTE AND REGULATIONS INVOLVED

The relevant portions of Sections 22(a), 41 and 42 of the Internal Revenue Code of 1939, and Section 29.41-1 of Treasury Regulations 111, are set forth in the Appendix, *infra*, pp. 11-13.

## STATEMENT

Vance L. Wiley and Frank D. Wiley were equal partners of Wiley Trailer Mart. In 1950 and 1951, the partnership kept its books and records on an accrual basis. During those years, its principal business was the purchase and sale of new and used trailers. Upon the sale of a trailer, it customarily received only a portion of the purchase price in cash or in credit for a used trailer. The customer would execute and deliver to the partnership an installment

note, secured by a conditional sales contract, for the balance of the purchase price. The face amount of these notes included insurance premiums, interest, and other charges computed to the maturity of the notes. During 1950 and 1951, the partnership customarily transferred the installment notes and conditional sales contracts which secured them to either the Minnehoma Financial Company of Tulsa, Oklahoma, (Minnehoma) or the Commerce Union Bank of Nashville, Tennessee (Commerce Union) (R. 58a-59a.)

In 1948, the partnership entered into a contract with Minnehoma providing the terms under which Minnehoma would accept installment notes. In 1949, this contract was amended to provide that the finance company was establishing a dealer reserve account against which delinquent payments and defaults would be charged and, when the account exceeded 20% of the total balance of the paper outstanding, the excess would be paid to the taxpayer. It also provided that the finance charge should be increased to 6%, 1/6 of which would be credited to the dealer reserve account along with 5% of the unpaid balance of each contract. On November 10, 1950, the partnership entered into a new contract with Minnehoma which remained in force through 1951. It provided for a finance charge of 5% on new trailers and 6% on used trailers. It stated (R. 60a-61a):

> 7. An amount to be determined by Minnehoma from time to time in its absolute discretion equal to not more than 5% of the aggregate of the retail cash sale price of the trailer coach

> and all extra equipment and * * * [other expenses paid by the partnership] less the amount of the down payment made by the purchaser * * * will be credited by Minnehoma to a special reserve account in the name of * * * [the partnership] which account will be referred to as the "Dealer Reserve Account". In addition, Minnehoma may credit to such Dealer Reserve Account * * *, but shall not be obligated so to do, * * * 1 10 on new trailers and * * * 1 12 on used trailers, or such other portions as Minnehoma may determine from time to time, of the finance charge paid or agreed to be paid by the purchaser in each contract. * * * Minnehoma may, at its own option, charge against the Dealer Reserve Account any sums that the * * * [partnership] may at any time owe to Minnehoma in any connection whatsoever. In the event * * * the Dealer Reserve Account shall exceed 15% of the aggregate unpaid balances of all contracts purchased by and assigned to Minnehoma * * * [by the partnership] plus all contingent liabilities which * * * it may have with respect to such contracts, Minnehoma will pay such excess to * * * [the partnership] * * * [A]t such time as all contracts * * * purchased and assigned to Minnehoma by the * * * [partnership] shall have been paid in full * * * and in the opinion of Minnehoma there shall be no contingent liability on the part of Minnehoma with relation thereto, Minnehoma shall pay to the * * * [partnership] the balance of the credit in such Dealer Reserve Account. * * *

During 1950 and 1951, Minnehoma allowed the partnership a portion of the finance charges. On its books it established accounts in the partnership's

name, constituting dealer reserve accounts to which were credited the 5% "holdbacks" and the partnership's share of the finance charges. (R. 61a.)

During the taxable years, Commerce Union purchased installment notes from the partnership under the terms of an oral agreement. An outline of this plan of operation was set forth in a letter from Commerce Union to the partnership, dated March 21, 1951, and was agreed to and acknowledged by taxpayer Frank D. Wiley on behalf of the partnership. This letter provided in part for procedure in the event of default and repossession; for a 5% holdback on all trailer contracts in excess of 36 months; and for finance rates, with a credit to the partnership's dealer reserve account of a percentage of the "unpaid balance", which varied in accordance with the term of the note and type of trailer sold. Commerce Union was to pay the partnership everything credited to the dealer reserve account in excess of 5% of the partnership's contingent liability on all notes purchased from it by the bank. (R. 62a-63a.)

Minnehoma and Commerce Union credited the partnership accounts with a share of the finance charges as each note was purchased. If the makers of the notes satisfied their obligations prior to maturity, they were relieved from paying some of the finance charges and Minnehoma and Commerce Union would debit the partnership accounts for a portion of the relieved charges. During 1950 and 1951, the partnership repurchased from Minnehoma and Commerce Union all defaulted notes and no-

losses were charged to the partnership's reserve. (R. 63a-64a.)

Both Minnehoma and Commerce Union notified the partnership periodically of the total amount of the partnership's share of finance charges which was held in its name. The ultimate balance of these finance charge credits, after payment of all notes by the purchasers and payment of all amounts due by the partnership to Minnehoma and Commerce Union, was to be paid to the partnership. The partnership did not receive any cash payments during 1950 and 1951 for its share of the finance charges and was not entitled to any under its agreements. It received no interest on the amounts credited by Minnehoma and Commerce Union to its account and had no dominion or control over any part of those accounts. (R. 64a.).

The partnership was not obligated to sell and Minnehoma and Commerce Union were not obligated to purchase any trailer notes taken in by the partnership. The discounting of a note was a separate and distinct transaction between the partnership and the respective firm. Neither of these firms had anything to do with negotiations for the sale of trailers by the partnership. The partnership was allowed a share of the finance charges as a bonus or inducement for doing business with Minnehoma and Commerce Union. (R. 64a.)

As of December 31, 1949, 1950 and 1951, the balances and yearly increases of the partnership share of finance charges on all trailer notes purchased from the partnership by Minnehoma and

Commerce Union, which were credited by the firms to accounts in the name of the partnership, were in the following amounts (R. 64a-65a):

| | Balances | | | | |
|---|---|---|---|---|---|
| Firm | December 31, 1949 | December 31, 1950 | December 31, 1951 | Yearly increase 1950 | 1951 |
| Commerce Union | $5,623.55 | $ 9,409.98 | $38,338.56 | $ 3,786.43 | $28,928.58 |
| Minnehoma | — | 8,839.00 | 9,124.34 | 8,839.00 | 285.34 |
| Total | $5,623.55 | $18,248.98 | $47,462.90 | $12,625.43 | $29,213.92 |

The partnership returns for 1950 and 1951 did not report any accruable income relative to the finance charge credits to the accounts maintained in its name by Minnehoma and Commerce Union. Taxpayers, in their individual joint returns for 1950 and 1951, reported only their distributive share of the income reported by the partnership. (R. 65a.)

The Tax Court held that the yearly increase in credits in 1950 and 1951 to the partnership accounts by Minnehoma and Commerce Union, representing a portion of the finance charges on notes sold by the partnership, was taxable income to petitioners in 1950 and 1951, respectively. (R. 65a-69a.) The Court of Appeals affirmed. (Pet. 23-25.)

## ARGUMENT

1. The decision below is correct. There is no conflict in decisions or other reason warranting further review. This case involves essentially the same basic question that was decided by this Court in *Commissioner* v. *Hansen*, 360 U.S. 446. See also *Schaefer* v. *Commissioner*, 258 F. 2d 861 (C.A. 6th), certiorari

denied, 360 U.S. 917; and *Morgan* v. *Commissioner*, 29 T.C. 63, appeal pending. As the court below pointed out (Pet. 24-25), the facts here are indistinguishable from the facts in *Schaeffer* v. *Commissioner, supra*. Nor is this case distinguishable in principle from *Commissioner* v. *Hansen, supra*.

In effect, taxpayers contend here (as the taxpayers in part contended in *Hansen*) that, to the extent the credits in the dealer's reserve accounts reflected percentages of finance charges which the finance companies agreed to allow them, the amounts should in no event be regarded as their accrued income. In *Hansen*, at p. 469, this Court decided that the taxpayers had "wholly failed to sustain the burden of showing that *any* part of the amounts credited on the books of the finance companies to the respective Dealers Reserve Accounts was entitled to special treatment." (Emphasis added.) The Court did not hold that finance charges were entitled to special treatment; nor would the rationale which was employed in *Hansen* permit such a conclusion. It is true that in the instant case, as in *Schaeffer, supra* (Pet. 24), "the source of the dealer's reserve account set up on the books of the finance company represented an obligation on the part of the purchaser of the automobile-trailer to pay what is termed finance charges, but which were actually prepaid interest to the date of maturity of the note, *in addition* to the unpaid balance of the purchase price". But that additional amount, as the order below appropriately observes (Pet. 24), "was included in the note executed by

the purchaser of the trailer to the automobile dealer and sold by the dealer to the finance company." In so far as the taxpayers here were concerned, the sale of notes covering the installment sales of trailers was as much a part of their business as the sale of the trailers, and there is no reason why the gain from the sale of the notes (including the portion of the finance charges credited to the reserve accounts) should not be accrued when the sales occurred. *Shoemaker-Nash, Inc.* v. *Commissioner*, 41 B.T.A. 417. Similarly, in so far as the purchasers of the trailers were concerned, the total time balance (including finance and other charges), evidenced by the face amount of the paper made payable to the taxpayers' partnership, represented (along with the cash paid or the trade-in credit allowed) the price of the commodity purchased. As the Fifth Circuit was constrained to recognize in *Texas Trailercoach Inc.* v. *Commissioner*, 251 F. 2d 395, 397: "When we get down to what actually happens * * * the finance company * * * has a fixed percentage for its finance charges worked into the sale price" * * *.[1]

2. The decision below is not in conflict with *North*

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[1] The possibility of the prepayment of notes in any given year, and the consequent debiting of the reserve accounts with a portion of the finance charges theretofore credited, involves, we submit, no greater contingency here with respect to ultimate payment out of the reserves than this Court dealt with in *Commissioner* v. *Hanson*, *supra*. And in the instant case, the portions of the finance charges credited to the reserve accounts were subject to the same restrictions as the additional amounts credited; all amounts credited were subject to all of the partnership-dealer's liabilities to the finance companies.

*American Oil* v. *Burnet*, 286 U.S. 417, as taxpayers erroneously assert. (Pet. 9-10.) Under the claim of right doctrine enunciated therein (see also *United States* v. *Lewis*, 340 U.S. 590, and *Healy* v. *Commissioner*, 345 U.S. 278), taxpayers would be required to report the amounts in the reserve as income for the year in which the credits were made, even if it is assumed, *arguendo*, that the precise amounts which they had a right to receive were in dispute, or that eventually they might receive only part, or even none, of the amounts credited. Nor, as asserted (Pet. 10), is the decision below in conflict with *Bressner Radio, Inc.* v. *Commissioner*, decided May 28, 1959 (C.A. 2d), involving the receipt of prepaid amounts which the Second Circuit regarded as unearned in the year of receipt because they constituted the consideration for services to be rendered by the taxpayer in the future. The situation in the instant case is completely distinguishable.

## CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

J. LEE RANKIN,
*Solicitor General.*

CHARLES K. RICE,
*Assistant Attorney General.*

MEYER ROTHWACKS,
CAROLYN R. JUST,
*Attorneys.*

AUGUST, 1959

## APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation or personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 22(a).)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or

does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U.S.C. 1952 ed., Sec. 41.)

SEC. 42 [as amended by Sec. 114, Revenue Act of 1941, c. 412, 55 Stat. 687]. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) *General Rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

* * * *

(26 U.S.C. 1952 ed., Sec. 42(a).)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.41-1. *Computation of net income.*—Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditure which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keep-

ing his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See sections 29.42-1 to 29.42-3, inclusive.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

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